POLICY & RESOURCES COMMITTEE	Agenda Item 9 Brighton & Hove City Council

Subject:		**Treasury Management Strategy Statement 2020-21 – End of year review**		
Date of Meeting:		**1 July 2021**		
Report of:		**Interim Executive Director of Finance & Resources**		
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Ward(s) affected:		**All**		

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The 2020/21 Treasury Management Strategy Statement (TMSS) and Treasury Management Practices (TMPs) were approved by Policy & Resources Committee on 13 February 2020. The TMSS sets out the role of Treasury Management, whilst the TMPs and accompanying schedules identify the practices and procedures that will be followed to achieve the aims of the TMSS and that underpin the council's Treasury Management function.

1.2 The TMSS includes the Annual Investment Strategy (AIS) which sets out the key parameters for investing council cash balances and was approved by full Council on 27 February 2020.

1.3 Much of the detail within treasury management is described using technical language. To aid readers, a glossary of the main terms used in this report is included at **Appendix 1**.

2. RECOMMENDATIONS:

2.1 That Policy & Resources Committee (P&R) notes the key actions taken during the second half of 2020/21 to meet the TMSS and practices (including the investment strategy) as set out in this report.

2.2 That Policy & Resources Committee notes the reported compliance with the AIS for the six month period up to the end of March 2021.

2.3 That Policy & Resources Committee notes that the approved maximum indicator for investment risk of 0.05% has been adhered to and the authorised borrowing limit and operational boundary have not been exceeded.

3. CONTEXT/ BACKGROUND INFORMATION

3.1 The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available (i.e. liquid) when it is needed. Effective cash flow planning enables surplus monies to be invested in counterparties or instruments commensurate with the council's risk appetite, providing adequate liquidity is maintained.

3.2 The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn on may be restructured to meet council risk or cost objectives.

3.3 The contribution the treasury management function makes to the authority is therefore critical, as the balance of debt and investment operations ensure liquidity and the ability to meet spending commitments as they fall due, either on day-to-day revenue spending or for larger capital projects. The treasury operations also therefore influence the interest costs of debt and the investment income arising from cash deposits which has implications for the council's budget.

3.4 Since cash balances generally result from holding earmarked and committed reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund.

3.5 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities (arising usually from capital expenditure) and are separate from the day to day treasury management activities.

3.6 The Chartered Institute of Public Finance & Accountancy (CIPFA) defines treasury management as:

"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks."

A key element of the Treasury Management Policy & Strategy concerns prudential indicators. These require the council to set limits on external debt and borrowing activity. These are set in the context of capital financing requirements but, more importantly, in the context of overall affordability. Anything borrowed must ultimately be repaid. All councils are required to set aside Minimum Revenue Provision (MRP) for debt but must also consider whether repayments will be affordable both now and in the longer term when resources may be predicted to reduce. Financing costs (principal and interest repayments) must also be budgeted for and any increase in repayments may therefore reduce the resources available for providing other essential services.

Economic Background

3.7 The council's treasury advisors, Link Asset Services, have provided their assessment of the UK and global economic landscapes over 2020/21 at **Appendix 2**.

3.8 The expectation for interest rates within the treasury management strategy for 2020/21 was that Bank Rate would rise from 0.75% to 1.25% by the end of 2022/23. This forecast was superseded before the financial year started as a result of the Covid-19 pandemic, which caused the Monetary Policy Committee (MPC) to reduce bank rate in March 2020, first to 0.25% and then again to 0.10% to counter the negative impact of the national lockdown on a substantial proportion of the economy. The official Bank Rate has remained at for the whole financial year.

3.9 The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with substantial amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more cash in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

Treasury Management Strategy

3.10 A summary of the action taken in the 6 months to March 2021 is provided in **Appendix 3** to this report. The main points are:

- The council entered into £10.0m of new borrowing in December 2020 to fund the HRA Capital Programme;
- No new General Fund borrowing was undertaken in the second half of the year;
- The highest risk indicator during the period was 0.009% which is below the maximum benchmark of 0.050%;
- The return on investments has exceeded the target benchmark rates in each of the 6 months;
- The two borrowing limits approved by full Council have not been exceeded.
- The Council entered into 2x new Bond Funds with Royal London Asset Management in February 2021
- There was a temporary breach of the investment limits of two of the council's Money Market Funds for a period of 4 days in January 2021. This is explained in further detail in paragraph 3.24.

3.11 Investment activity for the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1 Oct 2020 to 31 Mar 2021				
	Fixed deposits	Pooled Funds	Money market funds	Total	
Up to 1 week	-	£10.0m	£314.4m	£324.4m	86%
Between 1 week & 1 month	-	-	-	-	0%
Between 1 month & 3 months	-	-	-	-	0%
Over 3 months	£52.0m	-	-	£52.0m	14%
	£52.0m	**£10.0m**	**£314.4m**	**£376.4m**	**100%**

Summary of Treasury Activity October 2020 to March 2021

3.12 The following table summarises the treasury activity in the half year to March 2021 compared to the corresponding period in the previous year:

October to March	2018/19	2019/20	2020/21
Long-term borrowing raised (General Fund)	(£10.0m)	(£0.0m)	(£0.0m)

Long-term borrowing raised (HRA)	(£16.0m)	(£7.5m)	(£10.0m)
Long-term borrowing repaid (General Fund)	£14.9m	£0.8m	£0.8m
Long-term borrowing repaid (HRA)	£16.6m	£0.4m	£0.4m
Short-term borrowing (raised)/repaid	(£6.0m)	(£2.0m)	(£0.0m)
Investments made	£337.3m	£369.4m	£376.4m
Investments maturing	(£352.8m)	(£367.1m)	(£372.1m)

3.13 The Financing Costs budget variance in 2020/21 was £1.272m underspent. The key variance (£1.140m) is a large reduction in interest costs and minimum revenue provision as a result of pausing the capital programme in response to the pandemic during the year. The other key variance (£0.111m) is due to an over achievement of investment income as a result of higher balances. The higher investment balances were due to a combination of significant cashflow support provided by the government during the year to support the authority's pandemic response, and as a result of pausing elements of the capital programme (i.e. cash balances have not been drawn down as quickly as expected).

3.14 The following table summarises how the day-to-day cash flows in the second half-year have been funded compared to the same period in the previous year:

October to March	2018/19	2019/20	2020/21
Net cash flow (shortage)/surplus	**(£20.3m)**	**(£6.9m)**	**(£4.0m)**
Represented by:			
Increase/(reduction) in long-term borrowing	(£5.5m)	(£6.3m)	£8.8m
Increase/(reduction) in short-term borrowing*	£6.0m	£2.0m	£0.0m
Reduction/(increase) in investments	£15.5m	£2.3m	(£4.3m)
Reduction/(increase) in bank balance	£4.3m	(£0.9m)	(£0.5m)

**South Downs National Park external investments plus temporary borrowing*

Investment Strategy

3.15 A summary of investments made by the in-house team and outstanding as at 31 March 2021 in the table below shows that investments continue to be held in good quality, short term instruments.

'AAA' rated money market funds	£25.01m	17%
'AA' rated institutions*	£73.00m	50%
'A' rated institutions	£37.00m	26%
'BBB' rated institutions	£0.00m	0%
Unrated Funds	£10.00m	7%
Total	**£145.01m**	**100%**
Period – less than one week	£38.01m	27%
Period – between one week and one month	£5.00m	3%
Period – between one month and three months	£5.00m	3%
Period – between three months and 1 year	£67.00m	46%
Period – more than 1 year**	£30.00m	21%
Total	**£145.01m**	**100%**

** For the purposes of this analysis, other Local Authorities are assumed to have the same credit rating as the UK government (AA).*

*** All investments that are over one year either have a legal offset against debt with the same counterparty, or are with other Local Authorities.*

Risk

3.16 As part of the investment strategy for 2020/21 the council agreed a maximum risk benchmark of 0.050% i.e. there is a 99.95% probability that the council will get its investments back. The benchmark is a simple target that measures the risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.006% and 0.009% between October 2020 and March 2021, reflecting the high proportion of investments in high security and/or very liquid investments. It should be remembered however that the benchmark is an 'average risk of default' measure and does not constitute an expectation of loss for any particular investment.

3.17 The treasury management service is subject to a detailed audit on a regular basis. This includes the testing of the control environment and the management of risk. A 'reasonable' level of assurance was provided during the most recent audit (October 2019). One medium and two low recommendations were made which have all been implemented.

Investment Rates

3.18 The Bank of England's MPC have left the Bank Rate unchanged over the year at a rate of 0.10%. As part of the response to the pandemic and lockdown, the Bank of England and the Government provided financial markets and businesses with access to credit, either directly through grants and loans or through banks. In addition, the Government has provided grants to local authorities to assist with local responses to the pandemic; this has caused some local authorities to have sudden large and temporary increases in cash which is caused investment rates for lending between local authorities to fall significantly as supply of cash is much higher than the demand for borrowing. Additionally, many of the Council's investment counterparties have reduced rates in response to both the reduction in the bank rate and the surplus of short term cash in the markets, with some very short term products even offering negative investment rates.

3.19 Money market fund (MMF) yields have reduced significantly over the year, again as a result of the large supply of short term cash in the markets, and many fund managers have needed to reduce their fee levels to maintain a net positive (or at least at 0.00%) for investors. MMF Managers are not expecting that fund yields will turn negative for investors.

Investment Performance

3.20 The council's investment portfolio achieved an average rate of 0.49% over the last six months of the year against a benchmark rate of 0.01% for the same period. The benchmark rate for 2020/21 was set at is the 7 Day LIBID plus 0.10%. The 7 Day LIBID the rate at which UK banks are willing to pay for borrowing for a 7-day period (which has been negative during 2020/21). The Investment portfolio has therefore outperformed the benchmark by 0.48% in the second half of the year.

3.21 The following table summarises the performance achieved on investments compared to the budgeted position and approved benchmark for the whole year.

	In-house Investments

	Average Balance	Average rate
Budget 2020/21	£85.8m	1.15%
Actual 2020/21	£180.7m	0.62%
Benchmark Rate*		0.03%

**benchmark rate was set at 7 Day LIBID +0.10% for 2020/21. The 7 Day LIBID was negative during the last 6 months at an average rate of -0.07%*

3.22 Action was taken to invest in some longer-term instruments during the last 6 months of the year, once officers had established a higher degree of certainty over the medium-term cash flow position. A total of £10.0m was invested into two pooled bond funds managed by Royal London Asset Management. These funds had previously been selected as part of a selection process facilitated by the council's Treasury Advisors, but investment into the funds had been paused during the early part of 2020/21whilst the impact of the pandemic on the economy was understood. The two funds do not hold credit ratings, but a due diligence process was undertaken on the funds to ensure the underlying assets and strategic approach and outlook of the funds were in line with the council's risk appetite. This due diligence was refreshed in January 2021 prior to entering into the funds.

3.23 These funds are technical treated as short term investments, in that the funds can be called back with two days notice. However, in reality, as a result of the higher levels of pricing volatility of funds of this type, an investment time horizon of 3 to 5 years is expected.

Compliance with the Annual Investment Strategy

3.24 A temporary breach of the investment limits of two of the council's Money Market Funds occurred for period of 4 days in January 2021. The total breach was £7.0m across two funds. The breach was a result of cash for lockdown business loans paid over from central government earlier than anticipated.

3.25 The breach was assessed and agreed with the Section 151 Officer in advance as the most appropriate action: a temporary increase in AAA rated Money Market Fund balances was the most secure means of holding this cash on a temporary basis without costing the council to place it somewhere.

3.26 All other parameters in the Annual Investment Strategy has been complied with in full.

Borrowing Strategy

3.27 Following consultation with Local Authorities by HM Treasury, the PWLB amended its Lending Arrangements to Local Authorities in November 2020. The changes prevents local authorities from borrowing from the PWLB if it has "Debt for Yield" projects (projects where the primary intention is to create revenue income) within their capital investment plans. The PWLB also removed the additional 1% margin that it had added to new General Fund Borrowing in October 2019.

3.28 The General Fund has been carrying an internal borrowing position (i.e. where the General Fund borrows cash from its own reserves) since 2008 as a response to the financial crisis. In response to a combination of an expectation of increasing interest rate forecasts, the reduction of certain reserves and historically low PWLB borrowing rates, the General Fund has entered into planned borrowing of £27.5m from the PWLB to reduce the internal borrowing position over the last three years. The most recent of this borrowing was undertaken in August 2019, where a £7.5m loan was undertaken for a period of 50 years at a historical low rate of 1.67%. Additionally, £10m of PWLB borrowing was undertaken by the General Fund in March 2019 as part of a debt restructure to replace Royal Bank of Scotland (RBS) loans.

3.29 The Housing Revenue Account (HRA) carries a fully funded borrowing position (i.e. the HRA does not borrow from its own reserves, but instead undertakes borrowing for its entire borrowing requirement). Over the last three years, the HRA has entered into a total of £34.0m of external borrowing and £4.5m of borrowing from the General Fund to support the HRA Capital Programme. Of the £34.0m, £2.5m was undertaken in August 2019 for a period of 50 years at an interest rate of 1.67%. A second loan of £7.5m was undertaken in March 2020 for a period of 50 years at an interest rate of 1.54%, this was to support the HRA Capital Programme, and to externalise a portion of the loan from the General Fund at an attractive interest rate. Two further loans of £5.0m each were undertaken in December 2020. These loans were taken at 50 and 15 year maturity at interest rates of 1.28% and 1.32% respectively. Additionally, £16m of PWLB borrowing was undertaken by the HRA in March 2019 as part of a debt restructure to replace RBS loans.

3.30 The treasury management team, along with the its advisors, monitor interest rates and will seek to externalise the remainder of the HRA's borrowing from the General Fund at a time which would be optimal for both the HRA and the General Fund. The Treasury Team are also exploring alternative borrowing sources, such as forward market borrowing for future capital investment plans.

3.31 A summary of the council's debt portfolio is included in **Appendix 4**.

Treasury Advisors

3.32 Officers recognise that responsibility for decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources.

Member Training

3.33 It is a requirement of CIPFA's Treasury Management code to ensure that the members responsible for decision making and scrutiny of the authority's TMSS are adequately trained to undertake their roles in this area.

3.34 Treasury Management training was last provided in October 2019. Training has been arranged in October 2021 for members of Policy & Resources and the Audit & Standards committees.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 Alternative treasury management policies and practices, and investment strategies, are considered annually by Policy & Resources Committee and full Council. This report sets out action taken in the 6 months to March 2021. Treasury management actions have been carried out within the parameters of the approved AIS, TMSS, and Prudential Indicators and therefore no alternative options have been exercised.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted over the content of this report. No other consultation has been undertaken.

6. CONCLUSION

6.1 Treasury management is governed by a code that is recognised as "best and proper practice" under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is required to review the previous year's performance. This report fulfils this requirement.

7. FINANCIAL & OTHER IMPLICATIONS:

<u>Financial Implications:</u>

7.1 The financial implications of treasury management activity are reflected in the financing costs budget set out in paragraph 3.13.

Finance Officer Consulted: James Hengeveld Date: 09/06/21

<u>Legal Implications:</u>

7.2 The TMSS is approved and associated actions carried out under the powers given to the Council by Part 1 of the Local Government Act 2003 to invest for the purposes of the prudent management of its financial affairs (section 12).

7.3 Local authorities are required to have regard to statutory guidance in the form of the *Prudential Code for Capital Finance in Local Authorities* (2017 ed), issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) when carrying out functions under Part 1 of the Act.

7.4 The Council's approach is consistent with the requirements of the Act and the afore-mentioned Code.

Lawyer Consulted: Victoria Simpson Date: *10/06/21*

<u>Equalities, Sustainability and other significant implications:</u>

7.5 There are no direct implications arising from this report.

SUPPORTING DOCUMENTATION

Appendices:

1. Glossary of terms
2. The Economy & Interest Rates – Link Asset Services
3. A summary of the action taken in the period October 2020 to March 2021

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations.
2. The Treasury Management Policy Statement, Treasury Management Practices and associated schedules 2020/21 approved by Policy &Resources Committee on 13 February 2020.
3. The Annual Investment Strategy 2020/21 approved by full Council on 27 February 2020.
4. Treasury Management Policy Statement 2020/21 – Mid-Year Review approved by Policy & Resources Committee on 3 December 2020.
5. Papers held within Finance, part of the Finance & Resources Directorate.
6. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2017.